

Memorandum

City of Lawrence

City Manager's Office

TO: David L. Corliss, City Manager
CC: Diane Stoddard, Assistant City Manager
FROM: Britt Crum-Cano, Economic Development Coordinator
DATE: June 24, 2014
RE: Technical Report: HERE Kansas request for public assistance on 1101/1115 Indiana Street

Project Overview

HERE Kansas, LLC, (project Developer) is proposing the redevelopment of the property located at 1101 & 1115 Indiana Street into an upscale, 7-story, mixed-use, student housing community. The \$75.5 million project will include approximately 237 apartment units, first floor retail consisting of approximately 13,137 square feet to accommodate multiple retail users, and an automated robotic parking garage.

Request for Support

A [Request Letter and Incentives Application](#) was received on June 10, 2014 from HERE Kansas, requesting a 12-year, 95% Neighborhood Revitalization Area (NRA) and the issuance of Industrial Revenue Bonds (IRBs) to receive a sales tax exemption on project construction materials.

The following presents details and analytical results associated with this request.

Neighborhood Revitalization Area (NRA)

Description of NRA and Purpose

The NRA is one of several economic development tools utilized by municipalities to promote economic growth through neighborhood enhancement. Authorized by the state, NRAs are intended to encourage the reinvestment and revitalization of properties which in turn have a positive economic effect upon a neighborhood and the City in general. The use of an NRA is particularly applicable for use in areas where rehabilitation, conservation, or redevelopment is necessary to protect the public health, safety or welfare of the residents of the City.

[Resolution 6954](#) outlines the City's policy for establishing an NRA. Typically, a percentage of the incremental increased value in property taxes (due to improvements) is rebated back to the developer/applicant over a period of time to help offset redevelopment costs and make the project financially feasible.

Typical Rebate Amounts & Duration

As per NRA policy, the City typically follows the below standard practice:

- Does not provide more than 50% rebate on incremental property taxes
- Does not establish an NRA for a period of time longer than 10 years

However, there is an exception provision within the policy which allows the City to "*consider a greater rebate and/or a longer duration if sufficiently justified in the "but for" analysis.*"¹

¹ Resolution 6954, Section 4: Amount of Rebate

NRA Project Eligibility

Project eligibility for NRA consideration is governed by both State (KSA 12-17,114 et seq.) and City policy.

State Requirements

Statutory Criteria	Governing Body determines that rehabilitation, conservation or redevelopment of the area is necessary to protect the public health, safety or welfare of residents and the proposed project meets at least one of the below criteria:		
	1	An area in which there is a predominance of buildings or improvements which by reason of dilapidation, deterioration, obsolescence, inadequate provision of ventilation, light, air or open spaces, high density of population and overcrowding, the existence of conditions which endanger life or property by fire and other causes or a combination of such factors, is conducive to ill health, transmission of disease, infant mortality, juvenile delinquency or crime and which is detrimental to the public health, safety or welfare.	<i>Health & Safety Need</i>
	2	An area which by reason of the presence of a substantial number of deteriorated or deteriorating structures, defective or inadequate streets, incompatible land uses relationships, faulty lot layout in relation to size, adequacy, accessibility or usefulness, unsanitary or unsafe conditions deterioration of site or other improvements, diversity of ownership, tax, or special assessment delinquency exceeding the actual value of the land, defective or unusual conditions of title, or the existence of conditions which endanger life or property by fire and other causes or a combination of such factors substantially impairs or arrests the sound growth of a municipality, retards the provision of housing accommodations, or constitutes an economic or social liability and is detrimental to the public health, safety or welfare in its present condition and use.	<i>Economic Need</i>
	3	An area in which there is a predominance of buildings or improvements that should be preserved or restored to productive use because of age, history, architecture or significance should be preserved or restored to productive use.	<i>Preservation of Community/Historical Asset</i>

Redevelopment of both properties into a mixed-use, residential and retail complex would address state statute requirements for an NRA. Redevelopment would replace dilapidated or deteriorating structures, which currently contribute to health and safety concerns, with new space that provide significantly more open space than required by City code, increased area density, environmentally friendly features, and increased economic potential.

For an NRA to be established, the project must not only meet statutory requirements, but also a majority of City policy criteria. The project meets City policy eligibility as detailed below:

City Policy: NRA Eligibility			
City Policy Criteria	When considering the establishment of a NRA, the City shall consider not only the statutory criteria, but if the project meets a majority of the below criteria:		Eligible
	1	The opportunity to promote redevelopment activities which enhance downtown	N
	2	Provides the opportunity to promote redevelopment activities for properties which have been vacant or significantly underutilized.	Y
	3	Provides the opportunity to attract unique retail and/or mixed use development which will enhance the economic climate of the City and diversify the economic base.	Y
	4	Provides the opportunity to enhance neighborhood vitality as supported by the City's Comprehensive Plan or other sector planning document(s).	Y
	5	Provides the opportunity to enhance community stability by supporting projects which embrace energy efficiency, multi-modal transportation options, or other elements of sustainable design.	Y
	Project must meet or exceed a 1:1.25 cost-benefit ratio.		Y

As indicated above, the proposed redevelopment of 1101/1115 Indiana Street properties by HERE Kansas appears to meet both State and City criteria for NRA eligibility.

Industrial Revenue Bonds (IRB)

Industrial Revenue Bonds are an incentive established by the State of Kansas to enhance economic development and improve the quality of life. Considered a "conduit financing mechanism" whereby the City can assist companies in acquiring facilities, renovating structures, and purchasing machinery and equipment through bond issuance, IRBs can be useful to companies in obtaining favorable rate financing for their project, as well as providing a sales tax exemption on project construction materials.

IRBs are repayable solely by the company receiving them and place no financial risk on the City. When IRBs have been issued, the municipality owns the underlying asset and the debt is repaid through revenues earned on the property that has been financed by the bonds. If the company defaults, the bond owners cannot look to the city for payment.

IRB Eligibility

Project eligibility for IRB consideration is governed by both State (KSA 12-17,114 et seq.)² and [City policy](#). According to City policy, the City may from time to time grant IRBs when the project under consideration helps further economic and community development objectives. Additional eligibility criteria, as stipulated in the policy, are outlined below:

IRB City Policy Criteria			
Item #	Policy Requirement	Project Delivers	Project Qualifies (Y/N)
1	Only those projects which qualify under Kansas Law will be eligible for IRB financing.		Y
2	<i>Proposed Project shall achieve one or more of the following public benefits:</i>		
	Meets economic goals of the City as set forth in policy and the Comprehensive Plan of Lawrence and Douglas County.	Estimated 17 direct, net new jobs created: 10 with an average salary of \$30,600 and 7 with an average salary of \$25,000.	Y
	Promotes infill through the development of vacant lots, the rehabilitation of deteriorated properties or the adaptive reuse of historic properties.	Project will replace deteriorating apartments at 1101 Indiana and dilapidated residential at 1115 Indiana.	Y
	Enhance Downtown		N
	Incorporate environmentally sustainable elements into the design and operation of the facility	On-premise bike storage, energy & water consumption efficiencies utilized throughout project, provides significantly more open space than required by City code (including an inactive green roof)	Y
	Provide other public benefits to the community, particularly as set forth in the Comprehensive Plan of Lawrence and Douglas County.	Increases area density, contributes to storm water management policies of the City by not increasing the amount of impervious surface found currently on the site.	Y
3	Prospective tenant shall show the financial capacity to complete the proposed project and successfully market the bonds ³ .	Development team has successfully completed over \$750,000,000 of development.	Y

² K.S.A. 12-1740 permits cities and counties to issue revenue bonds for the purpose of paying the costs of purchasing, acquiring, constructing or equipping facilities for the following business categories: Agriculture, Hospital, Natural Resources, Manufacturing, Commercial, Industrial, Recreational Development

³ Applicant informed Staff on 6-6-14 that they are in discussions with possible lenders for the project and will provide the letter showing ability to market bonds once they finalize those discussions.

Other IRB Considerations

City policy also mentions other project considerations when issuing IRBs. Those are outlined below, along with project notes.

IRB: Other Considerations (Preferred)			
Item #	Policy Requirement	Project Delivers	Project Qualifies (Y/N)
1	City looks more favorably upon projects that support the below targeted industries:		
	Life Sciences/Research	n/a	N
	Information Technology	n/a	N
	Aviation and Aerospace	n/a	N
	Value-Added Agriculture	n/a	N
	Light Manufacturing and Distribution	n/a	N
2	The City favors issuing Industrial Revenue Bonds to projects that bring in new revenues from outside the community or enhance the local quality of life over projects that will primarily compete against other local firms.		
	Project anticipated to bring in new revenues from outside community:	Some revenue is assumed to be generated by renters coming from outside the community to attend the University.	Y
	Project enhances local quality of life:	Densification of desirable, safe residential options in close proximity to campus reduces need to drive: less vehicular congestion, increases safety, promotes walking and biking.	Y
		Incorporates automated robotic parking garage which dramatically reduces CO2 emissions in comparison to standard parking garage.	
		On-premise bike storage, energy & water consumption efficiencies utilized throughout project, provides significantly more open space than required by City code (including an inactive green roof)	

IRB: Special Consideration for Residential Projects			
Item #	Policy Requirement	Project Delivers	Project Qualifies (Y/N)
1	Project is multi-family or senior living project		Y
2	Projects that contain no non-residential uses and are requesting IRBS must have at least 30% of all housing units set aside for households making 80% of the Area Median Income or less.		n/a
Preferred Qualities for Residential Projects:			
	Infill or redevelopment:		Y
	Mixed -Use		Y
	Downtown Location	n/a	n/a

As indicated above, the proposed redevelopment of 1101/1115 Indiana Street properties by HERE Kansas appears to meet both State and City criteria for IRB eligibility.

Analysis

Estimated fiscal impacts to taxing jurisdictions is examined through a cost-benefit analysis and project financial feasibility is examined through a "But For" analysis (pro forma), both of which are required by current NRA policy. A cost-benefit analysis is also required by the City's IRB policy.

Cost-Benefit Analysis

Based on information received through the incentives application, staff conducted analysis of the costs and benefits associated with the project utilizing the City's economic development cost-benefit model. This model measures estimated fiscal impacts to four taxing jurisdictions: City, County, School District, and State. Furthermore, the model outputs a ratio reflecting the comparison of estimated costs to estimated benefits returned to the jurisdictions as a result of the project. The below assumptions were utilized within the model:

Capital Investment & Job Creation Assumptions:

According to the incentives application received, approximately \$75.5 million will be invested in purchasing and redeveloping the property. Project completion is anticipated in July 2016. Once redeveloped, the project is expected to support seventeen new, full-time jobs. Seven positions are anticipated to have an average annual salary of \$25,000 and 10 are anticipated to have an annual average salary of approximately \$35,600.

Sales Tax Assumptions:

IRBs are being requested for the project to receive a sales tax exemption on construction materials. Below are estimated project costs and foregone sales tax revenues by taxing jurisdiction if an IRB is issued.

Estimated IRB Sales Tax Exemption: 1101/1115 Indiana	
	Amount
Total Construction Costs	\$75,473,008
Estimated Construction Materials	\$27,616,342
Sales Tax Estimates	
City (1.55%)	\$428,053
County (1%)	\$276,163
State (6.15%)	\$1,698,405
Total Sales Tax Savings (8.7%)	\$2,402,622

Property Tax Assumptions:

In its present condition, the property generates approximately \$46,300 per year in real property taxes. Under the NRA program, these "base" property taxes are shielded from rebates and would continue to be paid by the property owner. Only a percentage of the incremental increase in property value resulting from project improvements is subject to NRA rebates and then only during the NRA period. After the NRA period, no reimbursements are made on property taxes and the property returns fully to the tax rolls.

2014 Estimated Base Valuation							
Year	Appraised			Assessed			Total Tax
	Land	Improvements	Total	Land	Improvements	Total	
1101 Indiana	\$737,000	\$2,347,800	\$3,084,800	\$84,755	\$269,997	\$354,752	\$44,943
1115 Indiana	\$50,070	\$42,230	\$92,300	\$5,758	\$4,856	\$10,614	\$1,345
Total Base Value	\$787,070	\$2,390,030	\$3,177,100	\$90,513	\$274,853	\$365,366	\$46,287

The following table provides a summary of the estimated base and incremental tax amounts the developer would be responsible for given a 10-year and 12-year NRA, assuming both 85% and 95% rebate scenarios. As base taxes are shielded from rebate, these tax revenues remain the same over the NRA period regardless of the rebate percentage granted.

Estimated Tax Paid from Developer: 95% NRA Rebate																
	BASE Year	Under Const.	Const. End July 2016	NRA Full Tax Year												
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	Total over 10 year NRA period (2017-2026)	Total over 12 year NRA period (2016-2027)
Base Taxes	\$46,287	\$46,362	\$46,438	\$46,513	\$46,589	\$46,664	\$46,740	\$46,816	\$46,892	\$46,968	\$47,044	\$47,120	\$47,197	\$47,274	\$468,542	\$562,253
Incremental Taxes	--	--	\$2,437	\$16,355	\$16,756	\$17,165	\$17,584	\$18,011	\$18,448	\$18,895	\$19,351	\$19,817	\$20,294	\$20,780	\$182,677	\$205,895
Total Taxes Due	\$46,287	\$46,362	\$48,875	\$62,868	\$63,344	\$63,829	\$64,324	\$64,827	\$65,340	\$65,863	\$66,395	\$66,938	\$67,491	\$68,054	\$651,219	\$768,148
															Amount due on Base Value	\$562,253
															Amount due on Incremental Value	\$205,895
															Total developer paid taxes over NRA	\$768,148

Estimated Tax Paid from Developer: 85% NRA Rebate																
	BASE Year	Under Const.	Const. End July 2016	NRA Full Tax Year												
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Incremental Taxes	--	--	\$7,312	\$49,065	\$50,268	\$51,496	\$52,752	\$54,034	\$55,345	\$56,685	\$58,053	\$59,452	\$60,881	\$62,341	\$548,030	\$617,684
Total Taxes Due	\$46,287	\$46,362	\$53,750	\$95,578	\$96,856	\$98,160	\$99,491	\$100,850	\$102,237	\$103,652	\$105,097	\$106,572	\$108,078	\$109,615	\$1,016,573	\$1,179,937
															Amount due on Base Value	\$562,253
															Amount due on Incremental Value	\$617,684
															Total developer paid taxes over NRA	\$1,179,937

Cost-Benefit Results:

City eligibility criteria prefers the project meet a cost-benefit threshold of 1:1.25 (e.g. for every \$1 of cost incurred as a result of the project, \$1.25 is received as benefit) for economic development projects.

Several cost benefit scenarios were ran utilizing information provided on the incentives application submitted by HERE Kansas. Results for 10 and 12 year NRA periods with rebate percentages of 85% and 95% are presented below.

Cost-Benefit Results: 1101 & 1115 Indiana Street					
Incentive Package	City	County	USD 497	State ⁴	Total Package Value
10-Year, 85% NRA, IRB for Sales Tax X (2017-2026)	1.26	1.38	14.67	n/a	\$5,669,571
12-Year, 85% NRA, IRB for Sales Tax X (2016-2027)	1.19	1.23	12.91	n/a	\$6,064,273
10-Year, 95% NRA, IRB for Sales Tax X (2017-2026)	1.18	1.20	12.59	n/a	\$6,034,925
12-Year, 95% NRA, IRB for Sales Tax X (2016-2027)	1.09	1.02	10.62	n/a	\$6,476,062

Cost/Benefit Threshold Met

Model [results](#) show that a 10-year, 85% NRA will meet or exceed the preferred cost-benefit ratio threshold for all taxing jurisdictions.

⁴ State does not have costs

"But For" Analysis

In order for the City to agree to provide an NRA rebate, it must be determined that the need for public assistance is necessary for the project to proceed. In other words, the City must be convinced that without public assistance, the project will not be financially feasible. Commonly referred to as the "But For" test, the developer's project pro forma and supporting financial documents are examined to compare cash flow and developer returns with and without public assistance.

The "But For" test for redeveloping the property utilized estimated project program information, annualized cash flow and pro forma data. Taxes were estimated using property information from Douglas County Appraiser's Office. Pro forma analysis provided the below results for a 10-year and a 12-year NRA.

Return Rates (est.)					
NRA Scenarios ⁵	Investment Threshold ⁶	1101/1115 Indiana Street			
		Average ROE: No Incentives	Average ROE: With Incentives	IRR: No Incentives	IRR: With Incentive
10 Year, 85% NRA (years 2017-2026)	8.10%	3.89%	5.64%	7.51%	9.03%
10 Year, 95% NRA (years 2017-2026)			5.75%		9.13%
12 Year, 85% NRA (years 2016-2027)			5.75%		9.69%
12 Year, 95% NRA (years 2016-2027)			5.88%		9.86%

Analysis shows the project's returns without City assistance is below estimated investment thresholds. Without incentives, average project return on equity (ROE)⁷ is 3.89% with internal rate of return (IRR)⁸ of 7.51% as compared to an 8.10% investment threshold. With the addition of City incentives, analysis shows the project's return on investment increases to more acceptable levels, with ROEs ranging between 5.64%-5.88% and IRRs ranging from 9.03%-9.89%.

Given these results, it is reasonable to assume that without incentives, the return rates for the project are too low to proceed.

⁵ All scenarios include IRB Sales Tax Exemption.

⁶ Investment threshold proxy = 2 * 10-Year average Treasury Bill rate.

⁷ Return on Equity: ROE = Cash Flow/Equity

⁸ Internal Rate of Return: IRR = Discount rate that makes the net present value of all cash flows from a particular project equal to zero. (IRR can be used to rank several prospective projects. Assuming all other factors are equal among the various projects, the project with the highest IRR would be considered the best and undertaken first.)

Performance Agreement

Per City policy, the property owner/development team would be required to enter into a performance agreement with the City in order to receive NRA rebates. The most significant reason for this is to make sure the developer coordinates with the City and County at the beginning of the establishment of the district and to ensure that there are no delinquent property taxes during any of the years of the NRA plan.

Conclusion

CBA Summary:

City eligibility criteria prefers the project meet a cost-benefit threshold of 1:1.25 (e.g. for every \$1 of cost incurred as a result of the project, \$1.25 is received as benefit) for economic development projects. The preferred cost-benefit ratio can be met assuming a 10-year, 85% NRA and IRB generating sales tax exemption on project construction materials.

"But For" Summary:

Examination of estimated cash flows with and without public assistance (i.e. NRA rebate and sales tax savings on construction materials) indicates the "but for" test has been met for the project. Returns without assistance are not likely to support proceeding with the project.

Recommendation

Given City policy guidelines, including eligibility requirements, cost-benefit thresholds, and "but for" provisions, Staff recommends approval of a 10 year, 85% NRA and the issuance of a stand-alone IRB.

Requested Action

Public Incentives Review Committee to consider applicant's request for a 12-year, 95% NRA and stand-alone IRB. PIRC to make recommendation to the City Commission regarding economic development support, including:

- Issuing stand-alone IRBs for a sales tax exemption on project construction materials.
- The establishment of a NRA:
 - If a NRA is recommended, PIRC to further recommend the duration period and rebate percentage for the project.